(12)

No. 97-1287

In the
SUPREME COURT of the UNITED STATES
October Term, 1998

**Hughes Aircraft Company, et al.,
Petitioners,**

v.

**Stanley I. Jacobson, et al.,
Respondents.**

**On Writ of Certiorari to the United States
Court of Appeals for the Ninth Circuit**

BRIEF AS AMICUS CURIAE OF THE NATIONAL EMPLOYMENT LAWYERS ASSOCIATION SUPPORTING RESPONDENTS

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BRIEF AS AMICUS CURIAE OF THE NATIONAL EMPLOYMENT LAWYERS ASSOCIATION SUPPORTING RESPONDENT

INTEREST OF AMICUS CURIAE[1]

The National Employment Lawyers Association ("NELA") is a voluntary membership organization of over 3,000 attorneys who regularly represent employees in labor, employment and civil rights disputes. It is the country's only professional membership organization of lawyers who represent employees in employee benefits, employment discrimination, wrongful discharge and other employment-related cases.

NELA has devoted its efforts to supporting precedent-setting litigation and legislation affecting the rights of individuals in the workplace. NELA has an interest in the application of the Employee Retirement Income Security Act ("ERISA") because the clients of NELA members frequently have employee benefit claims. NELA is qualified to brief this Court on the implications of its decision in this case, having participated as amicus curiae in numerous other cases involving ERISA and other employment laws, including *Varity Corp. v. Howe*, 516 U.S. 489 (1996), *John Hancock Mut. Life Ins. Co. v. Harris Trust & Savings Bank*, 510 U.S. 86 (1993), and *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989).

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[1] The parties have consented to the filing of this brief. Correspondence reflecting the parties' consent has been lodged with the Clerk. No counsel for any party has authored any portion of this brief. No persons other than NELA or its counsel have made a monetary contribution to the preparation and submission of this brief.

SUMMARY OF ARGUMENT

In the instant case, the employer, Hughes Aircraft Company ("Hughes Aircraft" or "Hughes") and salaried employees who so elected made contributions to fund a retirement plan for the exclusive benefit of the contributing employees and their beneficiaries. The employees made their contributions from after-tax income. Hughes Aircraft's contributions were from before-tax funds.

Over time, the employer and employee contributions generated sufficient funds to pay the benefits described in the plan's benefit formula and to leave a surplus. Hughes Aircraft discontinued its contributions to the plan in 1987. The Ninth Circuit upheld that discontinuance and the plaintiffs did not seek rehearing or certiorari concerning that decision.

Discontinuing its own contributions was not, however, enough for Hughes Aircraft. Hughes wanted to use the entire $1+ billion surplus, half of which had been generated by the employees' contributions, to fund other corporate pension obligations. In 1989 and 1990, Hughes adopted amendments to deplete the surplus for Hughes' own benefit.[2] By its 1990 amendment, Hughes took a surplus that had accumulated as a result of employee contributions by plaintiff Jacobson and other

[2] The Jacobson complaint alleged that the 1989 amendment, which conferred early retirement incentives on only a select group of participants, violated Section 5.2 of the Plan which provides that the Plan shall be administered and interpreted fairly and equitably. The Ninth Circuit ruled that this claim could not be dismissed. 105 F.3d 1302. Hughes did not petition for certiorari on this ruling and does not discuss it in its brief.

employees over a 40-year period and began to use that surplus to fund Hughes Aircraft's pension obligations to non-contributing employees. In essence, Hughes Aircraft contended that it owned the beneficial interest to the entire surplus.

NELA submits that the Ninth Circuit did not err in reversing the district court's dismissal under Rule 12(b)(6) of the employees' complaint for two reasons: First, the terms of the governing plan instruments -- the Plan document and Trust Agreement -- expressly prohibit use of the surplus funds for any purpose other than to benefit the contributing employees. Under the common law of trusts and ERISA, where the trust instruments contain such prohibitions, a settlor's purported amendment of those instruments to advance its own interests and diminish the beneficial interests of other persons who have contributed to the trust must not be given effect. If Hughes were allowed to take the contributory surplus as its own, Hughes would be taking the beneficial interest in all of the trust property as if Hughes was the only donor.

In addition, as explained below, Hughes' actions violated four sections of ERISA: ERISA §208, 29 U.S.C. §1058 (transfer of assets to new plan requires that assets distributable to employees on plan termination be protected), §403, 29 U.S.C. §1103 (inurement of assets to benefit of employer is prohibited), §404, 29 U.S.C. §1104 (fiduciaries, who are defined as the entities or persons with the authority to dispose of plan assets, have duty to act for exclusive benefit of participants) and §4044, 29 U.S.C. §1344 (surplus assets from employee contributions must be distributed to employees on plan termination).

ARGUMENT

I. The Obligations of ERISA Pension Trusts to Employees Who Make Employee Contributions Do Not Stop With Payment of Defined Benefits

Hughes' Brief repeatedly states that the Contributory Plan was a defined benefit plan, as if payment of the defined benefits precludes any further inquiries into Hughes' actions. Pet. Br. at 1-3, 12-13, 43-44. Hughes contends that because the plan is called a defined benefit plan, there can be no obligation to the contributing employees beyond paying the formulaic defined benefits. *Id.* As the rules described below demonstrate, this amounts to mere word play.

By the terms of its governing plan documents, any defined benefit plan, whether or not funded by employee contributions, may provide rights beyond the benefits defined in the basic benefit formula. For example, a pension plan may, by its terms, provide that the employee-participants have the right to all surplus assets upon plan termination. See, *e.g.*, *Delgrosso v. Spang & Co.*, 769 F.2d 928 (3d Cir. 1985), *cert. denied*, 476 U.S. 1140 (1986). As described in the next section, the governing instruments of the Hughes Plan created rights beyond the defined benefits payable to the participants under the plan's benefit formula. Thus, Section 6.5 of the Hughes Plan document and Section 4.2 of the Trust Agreement promised contributing employees that no amendment would divert any part of the Trust Fund to purposes other than their exclusive benefit.

ERISA creates several mandatory rights when a defined benefit plan is funded in part by employee contributions. First, ERISA requires that vesting in such contributions must be

immediate. ERISA §203(a)(1), 29 U.S.C. §1053(a)(1). Second, ERISA contains a large number of exceptions to the nonforfeitability of benefits derived from employer contributions, ERISA §203(a)(3)(A)-(F), 29 U.S.C. §1053(a)(3)(A)-(F), but there are no exceptions to the nonforfeitability of benefits derived from employee contributions. Third, the accrued benefit that must be provided to employees who make employee contributions must at a minimum equal the sum of their accumulated contributions with interest, regardless of the amount otherwise payable under the benefit formula. ERISA §204(c)(2)(B), 29 U.S.C. §1054(c)(2)(B).

Further, following the common law of trusts, ERISA expressly provides that employees who contribute to a defined benefit plan have conditional rights on termination of the plan and on transfer of any of the plan's assets before termination. As the Fifth Circuit concluded in *Borst v. Chevron*, "so far as concerns surplus assets, . . . ERISA . . . markedly distinguishes between those attributable to employee contributions and those attributable to employer contributions." 36 F.3d 1308, 1315 (1994).

First, under ERISA §4044(d)(3), 29 U.S.C. §1344(d)(3), employees who have made employee contributions to a pension plan with a surplus must receive a proportionate part of the surplus on termination of the trust. See *Holland v. Valhi, Inc.*, 22 F.3d 968 (10th Cir. 1994). Second, ERISA requires protection of the contributing employee's right to a proportionate share of the surplus assets if the employer seeks to transfer some of the plan's assets to a new plan. ERISA §208, 29 U.S.C. §1058, and the related Treasury Regulations at 26 C.F.R. 1.414(l)-1 require that the employees' share of the surplus assets be set aside for them in these circumstances as if the plan had terminated and an

ERISA §4044 termination-basis distribution had occurred. The proportionate share of the surplus that is due the contributing employees may not be transferred to another plan.

The protections afforded participants who make employee contributions were carefully considered. After hearings about a reversion to the Elgin Watch Company of surplus assets generated by employee contributions, the Senate Labor Committee concluded that it was "unfair to permit the complete recapture by employers of surplus funds in terminated contributory plans, without regard to the fact that contributions by the workers helped to generate the surplus." S. Rep. 93-127, 30, I ERISA Leg. Hist. 616, reprinted at 1974 U.S.C.C.A.N. 4835, 4856.

The distinctions that ERISA recognizes with respect to assets attributable to employee contributions are also found in trust law. In trust law, individuals who make contributions to a trust fund are described as "donors" or "contributors." When several donors contribute to a trust and the trust is fully performed without exhausting the trust assets, a resulting trust in the surplus arises in favor of the donors in proportion to their contributions. *Scott on Trusts*, §§411.6 and 430.3. A resulting trust arises because the circumstances raise an inference that the persons contributing to the trust did not intend for the trustee or any one donor to have the beneficial interest in all the property. *Restatement of Restitution*, §160, comment b.

As the Ninth Circuit stated in this case, "[i]n essence, when a plan is funded by both employer and employee contributions, both the employer and the employees are *co*-settlors of the plan." *Jacobson v. Hughes Aircraft Co.*, 105 F.3d 1288, 1296 (9th Cir. 1997). Although the Ninth Circuit did not cite author-

ity for this statement, it is an established principle of trust law that "[a] person who furnishes the consideration for the creation of a trust is the settlor . . . ." *Scott on Trusts*, Sec. 156.3 at p. 180. See also *Bogert, Law of Trusts & Trustees* (Rev'd 2d ed.), Sec. 41 at p. 428; *Ruocco v. Bateman, Eichler, Hill, Richards, Inc.*, 903 F.2d 1232, 1239 (9th Cir.), *cert. denied*, 498 U.S. 889 (1990) (employer was not settlor of disability plan where premiums were paid by employees). Logically, if more than one person funds the trust, both are settlors.

Elsewhere, Hughes Aircraft challenges whether the contributing participants have a "legally cognizable property interest" in the surplus trust assets. Pet. Br. at i. It is, however, black letter law that the beneficial interest of contributors/beneficiaries in surplus trust assets is a cognizable property interest. Many trusts provide for successive or conditional interests; the beneficiaries who receive the surplus after a designated period or event are called remaindermen or reversioners. See, *e.g.*, *Great Northern Iron Ore Properties*, 263 N.W.2d 610 (Minn. 1978), *cert. denied sub nom.*, *Arms v. Watson*, 439 U.S. 835 (1978). The *Restatement (Second) of Trusts* expressly provides:

> If a trust is created for beneficiaries in succession [for example, a beneficiary who receives the income during a designated period, with the remainder going to another beneficiary], the trustee is under a duty to the successive beneficiaries to act with due regard to their respective interests.

§ 232; see *id.* comment b (trustee under a duty to the latter beneficiary to "take care to preserve the trust property for him").

This Court's decision in *Varity Corp. v. Howe*, 516 U.S. 489, 514 (1996), recognizes the need to preserve assets to satisfy successive beneficial interests. In *Mahoney v. Boston Shipping Assn.-ILA Pension Plan Trustees*, 973 F.2d 968, 972 (1st Cir. 1990), then Chief Circuit Judge Breyer recognized not only the duty of impartiality between present and future beneficiaries, but also the stricter scrutiny that applies where the interests of beneficiaries are sacrificed to the interests of non-beneficiaries, as in *Struble v. New Jersey Brewery Employees' Welfare Fund*, 732 F.2d 325 (3d Cir. 1984). At least absent a reservation in the trust instruments, the interest of conditional beneficiaries may not be undermined by transferring surplus assets to finance other obligations of a non-beneficiary employer.[3]

As this court has recognized, establishment of an employee benefit plan is voluntary. *Lockheed Corp. v. Spink*, 517 U.S. 882, 887 (1996). However, once a plan is established, settlors and fiduciaries may not ignore or avoid the governing trust documents or ERISA. This is particularly true after contributions to the trust have been solicited from other donors, in this case, the employees. ERISA requires contributory defined benefit plans to recognize beneficial interests beyond those required for non-contributory plans. As demonstrated in the following sections, plaintiffs' complaint set forth claims that defendants' actions cut down those interests in violation of several provisions of law. Consequently, the Ninth Circuit

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[3] See *Restatement (Second) of Trusts*, §331, comment a (unless the settlor has reserved the power, he cannot modify the trust "by cutting down or taking away the interest of any beneficiary").

properly held that plaintiffs' claims should not have been dismissed on a Rule 12 motion.

II. Hughes' 1990 Amendment Violates the Rules of the Plan and Trust; Accordingly, Jacobson's Complaint Cannot Be Dismissed under Rule 12

Accepting the allegations of the complaint as true, Hughes Aircraft adopted an amendment in 1990 to use surplus assets attributable to employee contributions to finance Hughes' pension expenses for employees who never made contributions. As discussed below, that amendment was in violation of the terms of the Plan's governing instruments. Consequently, in putting the amendment into effect, Hughes, which also served as the Plan Administrator entrusted with interpreting the governing instruments, breached its fiduciary duties under ERISA. See ERISA §404(a)(1)(A), (B) and (D), 29 U.S.C. §1104(a)(1)(A), (B) and (D) (duties to act exclusively in the interests of participants, to act prudently, and to act in accordance with the governing plan documents).[4]

Section 6.5(b) of the governing Plan document expressly and plainly provided:

> No amendment shall be made at any time under which any part of the Trust Fund may be diverted to purposes other than for the exclusive benefit of Participants and their Beneficiaries . . . .

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[4] Plaintiffs may enforce their rights under the terms of the pre-1990 plan documents pursuant to ERISA §502(a)(1)(B), 29 U.S.C. §1132(a)(1)(B) (to enforce "rights under the terms of the plan") or §502(a)(3), 29 U.S.C. § 1132(a)(3) (to redress a violation of the terms of the plan or ERISA).

J.A. 97. Section 4.02 of the Trust Agreement, which may only be amended by agreement of the Trustee, contained the identical commitment that "[n]o amendment shall be made at any time under which any part of the Trust Fund may be diverted to purposes other than the exclusive benefit of the Participants and Beneficiaries." J.A. 184.[5]

The Plan document defined "Participants" as the non-bargaining unit employees who agreed to make Participant Contributions to the Plan. Specifically, Section 1.39 of the Hughes Plan document defined Participant as any person included in the Plan as provided in Article II. Article II provided that Participants were the nonbargaining unit employees who "as a condition precedent to participation" agreed to make Participant Contributions.[6] Hughes Aircraft's 1990 amendment violated the express terms of the Plan document and Trust Agreement by diverting part of the Trust Fund to purposes other than the exclusive benefit of the Participants and Beneficiaries -- the non-bargaining unit employees who made employee contributions and their beneficiaries.

Amicus believes that it would be circular to allow Hughes Aircraft to avoid this prohibition in the Plan document and Trust Agreement by amending the definition of Participants and Beneficiaries to include different groups of employees who never made any employee contributions to the Plan. The Plan

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[5] The briefs of the Petitioners and its amici nowhere address the express limitation on amendments in the Hughes Plan document and Trust Agreement.

[6] The Record below contains these definitions but they were omitted from the Joint Appendix. They are contained in an appendix to the Respondents' brief.

document and Trust Agreement refer to the Participants and Beneficiaries with capitalized first letters. The definitions of those terms limit the employees to those who contribute to the Plan.

A motion to dismiss may not be granted "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). The complaint alleged that Hughes failed to follow the Plan's own terms in violation of ERISA. At a minimum, those terms are ambiguous and present an issue of interpretation that the District Court must resolve. Accordingly, the Ninth Circuit correctly held that Jacobson's complaint should not have been dismissed on a Rule 12 motion.

III. Employers Are Not "Generally Free" to Amend Contributory Pension Trusts in Violation of Trust Rules or ERISA's Protections for Contributing Employees

In its Petition and Brief, Hughes Aircraft contends that the Ninth Circuit erred by refusing to follow this Court's holding in *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996), that the "act of amending the pension plan does not trigger ERISA's fiduciary provisions." *Amicus* respectfully submits the Ninth Circuit ruled correctly because this Court and others have concluded that while employers are "generally free" to amend employee benefit plans, the power to amend is not unlimited. See, *e.g.*, *Spink*, 517 U.S. at 891 ("other portions of ERISA govern plan amendments").

First, employee benefit plan fiduciaries may not implement amendments that violate either ERISA or the governing documents that the fiduciaries are entrusted with implementing. ERISA §404(a)(1)(D), 29 U.S.C. §1104(a)(1)(D). This duty parallels the duties of common law trustees who must interpret trust terms to determine the extent to which a settlor has reserved authority to use trust assets for the settlor's own benefit. See *Scott on Trusts* (4th ed.), §331 (if settlor reserves power to modify trust, he can only modify "to the extent to which he has reserved the power"); *Restatement (Second) of Trusts*, §331, comment a (settlor may not cut down or take away any beneficial interest unless authority to do so is reserved in terms of the trust).

In addition to the fiduciary duties to review amendments before implementing them, the Ninth Circuit concluded that ERISA's fiduciary duties are implicated when an employer, acting as both settlor and plan administrator, takes plan assets attributable to employee contributions and uses them to fund a new plan for employees who were never contributors. 105 F.3d 1296-98. In so holding, the Ninth Circuit distinguished *Spink* as a case where the employer used plan assets to give an extra benefit to one group of participants in the plan. This distinction is sound for three reasons. First, a disposition of plan assets for the credit of a sponsoring employer or union, instead of any participants in the plan, clearly implicates fiduciary duties. ERISA §3(21)(A), 29 U.S.C. §1002(21)(A), defines a fiduciary by reference to the exercise of "any authority or control respecting . . . disposition of [the plan's] assets." A transfer of pension plan assets to another plan implicates fiduciary duties even if the same employer sponsors both plans. See, *e.g.*, *Cutaiar v. Marshall*, 590 F.2d 523 (3d Cir. 1979) (fiduciaries violated ERISA by transferring assets to related plan). Second, to hold to the contrary would allow employers to undermine the beneficial rights to a contributory surplus that Congress mandated by taking surplus plan assets from the contributing employees and using them to finance the employer's obligations to non-beneficiaries.

Third, other circuits have reached the same conclusion where employers who double as plan administrators or trustees have taken trust assets for their own benefit through amendment or other formal action. In *Eaves v. Penn*, 587 F.2d 453 (10th Cir. 1978), an amendment converting a profit-sharing plan that originally limited investments in employer stock into an ESOP that would invest in employer stock disposed of plan assets in violation of ERISA's fiduciary duties. In *Struble v. New Jersey Brewery Employees' Welfare Fund*, 732 F.2d 325 (3d Cir. 1984), employer trustees breached their fiduciary duties when they voted to give surplus plan assets to themselves, instead of using the assets to provide benefits to retirees. See also *In re Gulf Pension*, 764 F. Supp. 1149, 1210 (S.D. Tex. 1991), *aff'd sub nom. Borst v. Chevron Corp.*, 36 F.3d 1308 (5th Cir. 1994), *cert. denied*, 514 U.S. 1066 (1995) (transfer of plan assets to pension plan established by purchaser of division violated fiduciary duties when it resulted in "dollar-for-dollar payback" to the seller); *Werschkull v. United Cal. Bank*, 149 Cal. Rptr. 829 (Cal. Ct. App. 1978) (amendment transferring excess assets from one plan for credit against contributions to another plan disposed of plan assets in breach of fiduciary duty).

Essentially, Hughes Aircraft has taken the surplus accumulated from employee contributions and credited it to its own account to finance non-contributing employees' pensions. This violated the express Plan rule described previously, and it violated ERISA's fiduciary duties because it disposed of assets

in a manner that benefited the employer, and not any of the contributory plan beneficiaries. As described below, Hughes' actions also violated ERISA's rules on transfers of assets and non-inurement of plan assets to the employer.

IV. Hughes Is Not Entitled to Dismissal of Jacobson's Claim that the Amendment Transferring Assets from the Contributory Plan to a New Non-Contributory Plan Violates ERISA Section 208

Relying on Treasury Regulation 1.414(l)-1(b)(1), Hughes Aircraft and its *amici* contend that the "alternative benefit structure" that Hughes created in 1990 could not possibly be a new plan. Hughes contends that if it creates a noncontributory plan but designates it as part of the contributory plan, its designation combined with the regulation require dismissal. See Pet. Br. at 27-29.[7] However, if the alternative benefit structure amounts to a new plan, the transfer of assets to finance it without protecting the participants' beneficial interest in the surplus violates ERISA §208, 29 U.S.C. §1058.[8]

The Treasury Regulation on which Hughes and its *amici* rest their case states only that a plan will not fail to be a single

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[7] The suggestion by Hughes that it could take the surplus even if the non-contributory structure was considered a new plan (Pet. Br. at 29 n.6) is mistaken. See 26 C.F.R. 1.414(l)-1(b)(5), (n) and (o).

[8] Such a transfer might also violate ERISA §406(b), 29 U.S.C. §1106(b). *Cutaiar v. Marshall*, 590 F.2d 523 (1979) (loan of assets by one plan to another with an identical board of trustees violated ERISA §406(b) where the participants in the plans were not identical); *Donovan v. Mazzola*, 716 F.2d 1226 (9th Cir. 1983), *cert. denied*, 464 U.S. 1040 (1984) (same).

plan "merely because" it "has several benefit structures which apply . . . to . . . different participants." 26 C.F.R. 1.414(l)-1(b)(1)(i) (*emph. added*). The regulation does not define "benefit structures," but the normal usage of the term is to describe a benefit formula or rates. See 29 C.F.R. 2520.102-4 and Solicitor General ("SG") Br. at 18-19. The "merely because" language means only that, standing alone, different benefit structures do not constitute different plans.[9] Petitioners' interpretation of this regulation would rewrite the regulation to provide that whenever an employer denominates something as a different benefit structure it can never amount to a new plan for purposes of the protection in ERISA §208.

Respondents' Complaint described the many respects in which Hughes "alternative benefit structure" was unlike the existing Contributory Plan and like a new plan. The most fundamental respect is that what was a Contributory Plan for 40 years is now purportedly both a Contributory and a Non-Contributory Plan. In the employee benefits field, pension plans are not both contributory and non-contributory: A plan is either one or the other. *Amicus* can find no treatise or other source that refers to a plan that is both.[10]

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[9] The Petitioners acknowledge that the "benefit structure" of a plan does not encompass its contribution structure. Pet. Br. at 20-21.

[10] See Dan M. McGill, *Fundamentals of Private Pensions* (Irwin 5th ed.), 87, 132-33, 165-69; Everett T. Allen, et al., *Pension Planning* (Irwin 8th ed.), 222-23; Michael G. Kushner, et al., *Employee Benefits Desk Encyclopedia* (BNA 1996) (definitions of "contributory plan" and "noncontributory plan"). A very small number of non-contributory plans accept employee contributions on a completely voluntary basis, with separate accounting for those

A plan that is both contributory and non-contributory would be like a Minotaur, half bull and half man. While the benefit formulas offered by a contributory and a non-contributory plan could be similar, the rules on participation, the ERISA rules, the funding mechanism, and the related accounting are completely different.[11] The separation between the two plans is also shown by Hughes' own description of the non-contributory plan to its employees as the "new retirement plan." J.A. 193. The separate nature of the two plans is further shown by looking at exhibits submitted by Hughes. The rules of each plan are stated in two separate Exhibits, Exhibits A and B, which are attached to the Verhey Declaration. J.A. 33-170. The two sets of rules are only joined by a cover document and boilerplate provisions which themselves differ in many cases depending on the "Applicable Exhibit." The only connection between the two plans with any significance is that Hughes is drawing on the surplus that accumulated under the Contributory Plan to fund the non-contributory "structure." The pretense that there is one plan is for one purpose -- to give Hughes access to the Contributory Plan's surplus assets.

ERISA has long recognized that plan sponsors cannot designate what is and is not an ERISA plan by their nomenclature. Rather, in deciding whether an employee benefit plan has been created, courts apply a functional test: whether "from the surrounding circumstances a reasonable person can ascertain the

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contributions. But a non-contributory plan that mandates employee contributions is a contradiction in terms.

[11] The benefit and tax rules on employee contributions require that plan administrators keep separate accounts of such contributions.

intended benefits, a class of beneficiaries, the source of financing, and procedures for receiving benefits." *Donovan v. Dillingham*, 688 F.2d 1367, 1373 (11th Cir. 1982) (*en banc*).[12] Petitioners and their *amici* appear to seek a rewritten regulation that would allow them complete freedom to avoid ERISA's substantive protections through names and not so carefully concealed shams.[13]

For these reasons, Respondents' complaint should not be dismissed on a Rule 12(b)(6) motion for "failure to state a claim on which relief can be granted." Respondents are entitled to the opportunity to prove that what Hughes designates as alternative benefit structures amount to "more than one plan." It is for the District Court to consider the parties' arguments on this point based on a developed record. If a Defendant can obtain a dismissal of allegations like these under F.R. Civ. P. 12, the regulations adopted to implement ERISA §208 will be rewritten as an unqualified rule that whatever an employer describes as an alternative benefit structure may never be a separate plan. That is not what the regulations provide.

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[12] *Dillingham* has been widely followed. See, *e.g.*, *Memorial Hospital Sys. v. Northbrook Life Ins. Co.*, 904 F.2d 236 (5th Cir. 1990); *Brown v. Ampco-Pittsburgh Corp.*, 876 F.2d 546 (6th Cir. 1989); *Northwest Airlines v. Federal Ins.* Co., 32 F.3d 349 (8th Cir. 1994).

[13] An employer cannot avoid the *Dillingham* principle by failing to adopt one or two legal formalities. Similarly, an employer cannot claim that a non-contributory plan is part of a contributory plan by adopting one or two insignificant legal formalities to bolster its position.

V. Whether the Ninth Circuit Erred in Refusing to Dismiss Respondents' ERISA Section 403 Inurement Claim Was Not Among the Issues Presented for Review; If the Court Considers Petitioners' Arguments, the Ninth Circuit's Decision Should Be Affirmed

Hughes' petition for *certiorari* did not request that this Court address the Ninth Circuit's refusal to dismiss Plaintiffs' first claim for relief, which alleged that by amending the plan to use plan assets to benefit itself, Hughes violated ERISA's anti-inurement rule: ERISA §403, 29 U.S.C. 1103. Petition for Writ of Certiorari at i. Both Hughes and the Solicitor General nevertheless ask this Court to hold that the Ninth Circuit erred in ruling that the anti-inurement claim should not dismissed. Brief for Petitioners at i (Question 2); SG Brief at I (Question 2).

The Ninth Circuit's ruling on inurement was not one of the questions presented to this Court for *certiorari*. Nor did the Petitioners argue against the ruling in the body of the brief in support of *certiorari*. This does not appear to be an oversight. The Ninth Circuit addressed this claim at greater length than any other claim. 105 F.3d at 1292-1296. It is well-settled that "only the questions set out in the petition, or fairly included therein, will be considered by the Court." Supreme Court Rule 14.1(a) and 24.1(a); *Yee v. City of Escondido*, 503 U.S. 519, 535-36 (1992); *Taylor v. Freeland & Kronz*, 503 U.S. 638, 645-46 (1992).

In an abundance of caution, however, we address the points the Petitioners raise. Like the Plan rule that no amendment shall divert part of the trust fund for purposes other than

the exclusive benefit of the employees who made contributions, ERISA's anti-inurement rule provides:

> Except as provided [under certain specified sections of ERISA], the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administration.

29 U.S.C. §1103(c)(1).

As the Ninth Circuit noted, there is no authority for the proposition that the anti-inurement provision is limited to situations where assets inure as a result of a fiduciary's actions. 105 F.3d 1294; *accord* SG Brief at 21. Thus, an amendment made by Hughes Aircraft as a non-fiduciary may violate the rule on inurement. There is also no question that the anti-inurement rule applies to "surplus" assets. As the Seventh Circuit held in *Hawkeye Nat'l Life Ins. Co. v. Avid Industrial Corp.*, 122 F.3d 490, 497-98 (8th Cir. 1997), the "assets of a plan" clearly encompasses surplus assets.

Finally, it cannot be seriously disputed that the 1990 amendment used the assets of the plan for the "benefit" of Hughes. SG Br. at 22-23 (Hughes used the surplus to fund the non-contributory benefits). As the Ninth Circuit stated, Hughes used the asset surplus to fund benefits for employees who were never participants in the Contributory Plan: "Had Hughes not used the Contributory Plan surplus" for these labor costs, "Hughes would have had to use its own revenues . . . ." 105 F.3d at 1296. Discharging obligations to third parties constitutes consideration under contract law and income under tax law and

must be considered to be a "benefit" for the employer under ERISA §403. ERISA §302, 29 U.S.C. §1082, makes the benefit to Hughes unmistakable. This section of ERISA imposes funding obligations on plan sponsors. When Hughes diverted assets from the contributory plan to fund its obligations to non-contributing employees, Hughes discharged its funding obligation under ERISA and thus unmistakably benefited from the diversion.

Where the Petitioners appear to differ with the Ninth Circuit is on the meaning of two terms in §403: "inure" and "participants in the plan." Following the Second Circuit, the Ninth Circuit decided that inure means "to become of advantage." 105 F.3d 1292. See also *Webster's New Universal Unabridged Dictionary* (2d ed. 1979) (including in definition of "inure" "to come into use" or "to serve to the use or benefit of"). Petitioners offer no other definition. Petitioners appear to contend that assets must be withdrawn for inurement to occur, Pet. Br. at 26, but that argument finds no support in the statutory text or the common meaning of "inure." Moreover, the Ninth Circuit held that even if that was the standard, the Jacobson complaint could not be dismissed under Rule 12, because the plaintiffs alleged that the assets were withdrawn and transferred to a new non-contributory plan. 105 F.3d at 1295.

The Solicitor General nevertheless argues that the anti-inurement rule does not protect the Respondents because §403 does not distinguish between "participants" who make employee contributions and those who do not. The Solicitor concludes that there is "no way to differentiate between the incidental gains that Hughes receives from the payment of benefits and other legitimate advantages realized by employers when they make benefit payments." SG Br. at 25. The Solicitor's argument is analyti-

cally flawed. It fails to recognize that §403 provides that the assets shall be used for the exclusive benefit of the "participants in the plan." The "participants in the plan" were limited to those who made employee contributions. The Solicitor's approach would mean that use of the assets for any employees who the employer makes eligible suffices. SG Br. at 21 and 23. This approach diminishes or downgrades §403's protection of the "participants in the plan" in a manner that is reminiscent of the *cy pres* ("as nearly as" practicable) doctrine applicable to charitable trusts where it is impossible or impractical to achieve the trust's original purpose. But the *cy pres* doctrine is not applicable at all to private trusts, *Restatement (Second) of Trusts*, §399 comment a, and it was, moreover, not impossible or impracticable to achieve the original purpose here -- using the assets for the contributing employees' exclusive benefit.

The Ninth Circuit clearly and repeatedly stated, in slightly different ways, that the problem with Hughes' amendment is that it used the surplus for the benefit of "employees who were never participants in the Contributory Plan." 105 F.3d at 1293, 1294 and 1295. Remarkably, neither Hughes Aircraft nor the Solicitor General directly respond to this point or suggest how the reference to "participants in the plan" reasonably extends to employees who were never participants in the plan. To avoid the Ninth Circuit's point, Hughes goes as far as to imply misleadingly, in two places, that it only offered new benefits to individuals who were already participants: "Hughes had done nothing but amend the plan to provide new benefits for plan participants." Pet. Br. at 25; *id.* at 44 (Hughes did "no more than add new benefits for plan participants").

If this Court adopts Hughes' argument, the result will be that assets accumulated under a contributory plan will inure to

the benefit of the employer, rather than the participants in the plan, as those terms are ordinarily understood. ERISA §403's anti-inurement rule will be a cardboard tiger that only looks as if it offers protection to participants in the plan.

If Hughes Aircraft was intent on reclaiming the part of the surplus that was attributable to Hughes' own contributions, ERISA §403(c)(1), 29 U.S.C. §1103(c)(1), contains an exception that allows Hughes Aircraft to do so. The conditions for that exception are that the plan be terminated and that the part of the surplus attributable to the employees' contributions be distributed to them under ERISA §4044(d), 29 U.S.C. §1344(d). The asset transfer rules in ERISA §208, 29 U.S.C. §1058, may also allow Hughes to take the portion of the surplus that accumulated as a result of Hughes' own contributions and use it to fund benefits for a non-contributory employee group without terminating the plan. But to do so, Hughes must preserve the portion of the surplus attributable to the employee contributions for those participants. Hughes Aircraft is not permitted to take the assets that are attributable to the employee contributions and use them as its own assets.

Thus, if the Court considers the anti-inurement issue (but see above), there can be no doubt that under the facts alleged by plaintiffs, the surplus assets of the Hughes plan have inured to the benefit of the employer and none of the exceptions to ERISA §403 apply. As the Ninth Circuit correctly pointed out, while Hughes "did not do anything so blatant" as to withdraw the funds from the contributory plan and deposit them in its corporate account, 105 F.3d at 1293, it used the funds from the contributory plan to finance its labor costs for participants who were never participants in the plan. Because this violated ERISA §403, dismissal under Rule 12(b)(6) is improper.

VI. The Equitable Remedies Available Under ERISA Include Constructive Trust and the Injunctive Power to Require that a Plan Be Terminated

Hughes seeks a ruling that the federal courts can never deem a pension plan to have terminated or order a plan terminated because it has become a wasting or dry trust.[14] The Court should not issue that ruling. Under the common law and ERISA, the courts have had the authority to order termination of trusts or employee benefit plans under various circumstances, including the following: to enforce contractual obligations (*American Flint Glass Workers Union v. Beaumont Glass Co.*, 62 F.3d 574, 580-81 (3d Cir. 1995); *Phillips v. Bebber*, 914 F.2d 31, 34 (4th Cir. 1990)); to replace the plan administrator or trustee by an independent fiduciary, such as a court-appointed bankruptcy trustee, who may order a termination (*In re Esco Mfg. Co.*, 50 F.3d 315 (5th Cir. 1995)); to close out an abandoned plan (*Chambers v. Kaleidoscope, Inc. Profit Sharing Plan*, 650 F. Supp. 359 (N.D. Ga. 1986)); where the trust's purpose can no longer be carried out (*Scott on Trusts*, §335 at p. 426; *Bogert*, §995 at p. 253); or where the plan has become a wasting trust (*In re Gulf Pension Litigation*, 764 F. Supp. 1149, 1201-1205 (S.D. Tex. 1991), *aff'd sub nom. Borst v. Chevron Corp.*, 36 F.3d 1308 (5th Cir. 1994), *cert. denied*, 514 U.S. 1066 (1995)).

Here, the Ninth Circuit held that the district court, on a motion to dismiss, could not rule out that Hughes' Contributory Plan had become a wasting trust and should be ordered termi-

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[14] If the plan is terminated, e.g., as a wasting trust, the surplus assets attributable to employee contributions must be distributed to the contributing participants. ERISA §4044(d)(3), 29 U.S.C. §1344(d)(3).

nated, rather than allowing the employer to continue to siphon its surplus. The Ninth Circuit held that "[o]nly after discovery can the district court properly determine whether the Contributory Plan's purposes have been accomplished and whether its liabilities are fixed enough to terminate the plan." 105 F.3d 1295 n. 3.

Hughes maintains that ERISA Title IV precludes a court from declaring a plan terminated or ordering an employer to terminate a plan because the plan has become a wasting trust or for any other reason.[15] As a matter of statutory construction, this position appears to be based only on the description of ERISA §4041, 29 U.S.C. §1341, as the "exclusive means" to terminate a plan (other than an involuntary termination by the PBGC pursuant to ERISA §4042), and a reference in the regulations to §4041 as a "voluntary" termination procedure. 29 C.F.R. 4041.3(a). From this scarce authority, Hughes comes up with a syllogism: A court cannot "order an employer to institute a 'voluntary' termination under section 1341; such a forced termination by definition would be <u>involuntary</u>." Pet. Br. at 40 (emph. in original).

The text of ERISA §4041 does not require, or even favor, a restriction on the historical equitable powers of the courts. To the contrary, the more reasonable and logical

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[15] The company-sponsored HARA, which appears as an *amicus* supporting Hughes, objects to termination of the Plan, but it does not articulate any interest that retirees have in allowing Hughes to continue to transfer the surplus earned by their contributions to Hughes to finance the benefits of non-contributing employees. The Solicitor General takes the position that the Court need not reach this issue. SG Brief at 16.

construction of the language is that Congress intended that §4041 be the exclusive procedure by which a plan adminisrator seeking to voluntarily terminate a plan may do so, but not to deprive the courts of the power to apply traditional trust law principles so as to require a plan to be terminated. The dictionary defines "means" as "that by which something is done or obtained." *Webster's New Universal Unabridged Dictionary; accord Black's Law Dictionary* ("[t]hat through which, or by which, or by the help of which, an end is obtained"). The means of termination must not be confused with the events that culminate in or necessitate termination. While the procedures of Title IV govern matters such as notification, priorities in distributing benefits, and the orderly close-out of defined benefit pension plans, Title IV is silent on the courts' equitable powers.

This is no accident. Congress intended that appropriate government agencies and the courts continue to address the substance and legality of termination. Thus, Congress asserted that a determination of "whether a proposed termination violates the contractual or statutory rights of any affected parties . . . must ultimately rest with the appropriate adjudicative entity, government agency, or court, as the case may be." H.R. Rep. 99-241, 293, *reprinted in* 1986 U.S.C.C.A.N. 579, 944. Given Congress' intent that Title IV's termination procedures not preclude the courts from ultimately determining whether termination should be allowed, it is not rational to believe that Congress intended for the Title IV procedures to preclude courts from declaring that terminations should be ordered or deemed to have occurred.

The appropriate judicial procedure is to allow the plaintiffs and Hughes Aircraft to present their evidence concerning whether the Retirement Plan has become a wasting trust

under traditional trust law principles. If the trial court finds that the plan has become a wasting trust that should be terminated, the court will determine the appropriate equitable relief for Hughes' earlier failure to distribute the surplus assets as required by ERISA §4044(d)(3).

Hughes' Brief sounds as if the only order that the plaintiffs seek is termination of the plan. In fact, the complaint requests a range of equitable remedies for Hughes' violations of ERISA and the terms of the Plan, including enjoining the defendants from using the assets for the purpose of paying benefits under the non-contributory plan, restoring assets previously used, equitably distributing excess assets attributable to employee contributions in the form of improved benefits, and appointment of an independent trustee -- in addition to ordering that the plan be terminated because it has become a wasting or dry trust.

The other remedies that the plaintiffs seek are not contested. *Mertens v. Hewitt Assoc.*, 508 U.S. 248 (1993), teaches that participants and beneficiaries have available the full range of equitable remedies applied by the courts of equity. *Id.* at 256. Among those remedies are the appointment of new fiduciaries and imposition of a constructive trust. A constructive trust may be imposed as a remedy for ERISA violations that unjustly enrich one donor at the expense of other contributors to a trust. See *Clothing & Textile Workers v. Murdock*, 861 F.2d 1406 (9th Cir. 1988); *Restatement of Restitution*, §160.[16]

[16] "A constructive trust is . . . the remedial device through which preference to self is made subordinate to loyalty to others." *Meinhard v. Salmon*, 249 N.Y. 458, 467, 164 N.E. 545 (1927).

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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